

# **Servicing and Monitoring**

## **Executive Summary**

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### **SECTION 9-1**

This chapter describes the Mark-to-Market Notes generated from the restructuring process, the overall servicing responsibilities, including cash and asset management, of the first mortgage, second mortgage, third mortgage, and Rehabilitation Escrow.

## **First Mortgage Servicing**

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### **SECTION 9-2**

First Mortgage Servicing. The first mortgage lender maintains cash management responsibility in accordance with the terms of the Note, Mortgage, Regulatory Agreement and the Mark-to-Market Rider to the Regulatory Agreement. The lender is responsible for administration and maintenance of the impound accounts (Reserve for Replacement, Property Tax, etc.). If the restructured deal includes repairs, the first mortgage lender (or another escrow manager) will maintain the rehabilitation escrow account. The asset management of the first mortgage if there is an FHA-insured or HUD-held mortgage after restructuring is the responsibility of the local Multifamily Hub or Program Center.

In the event there is a complete write-down and no take-out financing, the Mortgage Restructuring Note will be the first mortgage. In this event, the HUD Multifamily Financial Operations Division/Multifamily Notes Branch or its designee will service the note.

## **Second Mortgage Servicing**

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### **SECTION 9-3**

Second Mortgage Servicing. The Mark-to-Market Notes and Mortgages secure the repayment of HUD's mortgage insurance claim payment. In order to monitor and optimize the value of HUD's interest, Asset and Cash Management services will be provided by HUD or a Contractor. Enforcement of any rights under the

second mortgage is subject to approval of the MULTIFAMILY Hub or Program Center Director.

- A. **Cash Management.** The HUD Multifamily Financial Operations Division/Multifamily Notes Branch or its designee will provide the cash management servicing of the Mortgage Restructuring Note. Responsibilities include lock box payment receipt control, accounting records, billing, and reporting.
- B. **Asset Management.** The terms of the Mortgage Restructuring Note call for an annual payment based on a stated percentage (usually 75%) of surplus cash from the property. The surplus cash amount is initially captured from the project's fiscal year end Annual Financial Statement (AFS) submitted by the owner to the HUD Real Estate Assessment Center (REAC).
- C. **Asset Management Contractor.** An Asset Management Contractor will be responsible for the following:
  - 1. review and analysis of the AFS and other REAC and Asset Management data for approval criteria for any Capital Recovery Payment and Incentive Performance Fee,
  - 2. review and analysis of AFS for correct calculation of surplus cash and subsequent calculation of mortgage loan payment due to HUD; notifies Cash Manager of amount due,
  - 3. make payment demand in the event the owner fails to make annual payment,
  - 4. review the project financial statements, perform variance analysis of the actual operating expenses against those used in underwriting, develop recommendations for budgets, note payments, capital and maintenance expenditures, and other asset management options,
  - 5. site visits, physical inspections, meeting with tenants, and other actions as requested,
  - 6. maintain appropriate records, and
  - 7. work with the local FHA Asset Manager and Office of Housing personnel to optimize the value of HUD's interest in the M2M Notes.

## **Third Mortgage Servicing**

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### **SECTION 9-4**

Third Mortgage Servicing. Servicing of the third mortgage is limited so long as the second mortgage is outstanding to accounting for principal and interest balances, accepting payments, and other administrative functions. The payment terms of the Contingency Payment Note, at the option of the owner at the time of restructuring, are:

- A.** All due at maturity or, if the Mortgage Restructuring Note is paid in full prior to its maturity date, the balances are accelerated,
- B.** If the Mortgage Restructuring Note is paid in full prior to its maturity, the Contingency Payment Note can assume the position and payment terms of the Mortgage Restructuring Note.

## **Administering the Rehabilitation Escrow**

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### **SECTION 9-5**

- A. Selection of Rehabilitation Escrow Administrator.** The PAE, subject to the terms of the PRA, or a third party may act as escrow administrator.
- B. Compliance and Monitoring Activities.** The administrator shall oversee administration of the rehabilitation escrow, including the following functions:
  - 1. Process draws to pay for services rendered.
  - 2. Engage a third party inspector to verify that work is completed in accordance with the scope of work identified in the Restructuring Commitment. (Typically, the PCA inspector will be the best person to inspect the work.)
  - 3. Upon completion of work, distribute any excess escrow funds:
    - a. To the owner, in proportion to the owner's contribution for repairs; and
    - b. The balance to the first mortgagee, for deposit into the Reserve for Replacement account.
- C. Coordination with Lender.** The Escrow Administrator is responsible for arranging and coordinating the appropriate documentation procedures for draws with the Lender or third party handling the Rehabilitation Escrow Impound Account.

## **Use Agreement Compliance Monitoring**

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### **SECTION 9-6**

The Use Agreement will be monitored by HUD or by the PAE if the PAE is also serving as a Contract administrator. In the presence of an FHA insured first mortgage, M2M second or third mortgage, or project based Section 8 contract, most of the requirements of the Use Agreement will be monitored through the regulatory provisions in those documents. Per the terms of the Use Agreement, tenants and other third parties also have certain enforcement rights.

## **Section 8 Contract Administration**

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### **SECTION 9-7**

Public PAEs have the option to serve as Contract Administrators for any properties restructured (either as a Lite or as a Full). Compensation and performance standards will be established in an Annual Contributions Contract (ACC) and will be consistent with those used in Housing's solicitation for Contract Administrators for the non-M2M portfolio.